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December 16, 2005

Mr. Charles Terreni  
Chief Clerk/Administrator  
South Carolina Public Service Commission  
101 Executive Drive  
Columbia, SC 29210

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COMMISSION

RE: Docket No. 2005-191-E

Dear Mr. Terreni:

Enclosed for filing with the Commission are the original and twenty-five (25) copies of Progress Energy Carolinas, Inc.'s Brief in the above-referenced docket.

Sincerely,

A handwritten signature in dark ink, appearing to read 'Len S. Anthony'.

Len S. Anthony  
Deputy General Counsel-Regulatory Affairs

LSA:mhm

Enclosures

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**STATE OF SOUTH CAROLINA  
BEFORE THE PUBLIC SERVICE COMMISSION**

**DOCKET NO. 2005-191-E**

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COMMISSION

In the Matter of:

Generic Proceeding to Explore a                     )  
Formal Request for Proposal For                    )  
Utilities That Are Considering                     )  
Alternatives for Adding Generating                )  
Capacity   )

**CERTIFICATE OF SERVICE**

I, Len S. Anthony, hereby certify that Carolina Power & Light Company d/b/a Progress Energy Carolinas, Inc.'s (PEC) Brief has been served on all parties of record either by hand delivery or by depositing said copy in the United States mail, postage prepaid, addressed as follows this the 16th day of December, 2005:

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**STATE OF SOUTH CAROLINA  
BEFORE THE PUBLIC SERVICE COMMISSION**

**DOCKET NO. 2005-191-E**

In the Matter of:

Generic Proceeding to Explore a	)	
Formal Request for Proposal For	)	
Utilities That Are Considering	)	<b>PROGRESS ENERGY CAROLINAS,</b>
Alternatives for Adding Generating	)	<b>INC.'S BRIEF</b>
Capacity	)	

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Pursuant to the Commission's Order No. 2005-687, Carolina Power & Light Company, d/b/a Progress Energy Carolinas, Inc. ("PEC") submits its Brief demonstrating that the Commission should not initiate a rulemaking proceeding with the goal of adopting a rule requiring the electric utilities of South Carolina to procure all future generation resources via a request for proposals administered by an independent fourth party. In support thereof, PEC shows the following:

**EXECUTIVE SUMMARY**

It is important that the Commission recognize the genesis of this proceeding for exactly what it is: an attempt by a distressed merchant vendor to use the regulatory process to achieve an advantage in the sale of its product. This proceeding was not initiated because any electric utility in South Carolina has ever imprudently procured or selected a resource. In fact, no one, not even the merchant generators, have alleged this. Not a shred of evidence was produced at the hearing in this matter that the electric utilities of South Carolina have ever made an inappropriate or incorrect resource selection. Not a shred of evidence was produced indicating that the resource planning process used by the South Carolina electric utilities is flawed in any way. Rather, the

utilities demonstrated that the resource planning process and resource acquisition procedures they have used over the years have served the State well and produced an economic, diverse and reliable generation system that is the envy of the rest of the nation.

The merchant generators' entire argument that the Commission should require utilities to use requests for proposals ("RFPs") in every instance and responses to such RFPs should be evaluated by an independent fourth party, is based upon two fallacious assumptions: (1) the utilities cannot be trusted to prudently select new resources; and (2) the Commission and the Office of Regulatory Staff ("ORS") are either incapable or not competent to evaluate the utilities' proposed resource additions and determine whether such elections are appropriate.<sup>1</sup> No evidence was produced to support either assumption.

Thus, as thoroughly explained below, there is absolutely no basis for the Commission to adopt a rule requiring utilities to issue requests for proposals prior to obtaining a new resource and turning over the administration of such RFPs to a fourth party. In fact doing so will actually harm the utilities' abilities to make decisions in the best interests of their customers.

### **BACKGROUND**

By Order No. 2005-2 in South Carolina Electric & Gas Company's ("SCE&G") last rate case, at the request of Columbia Energy, LLC (a subsidiary of Calpine

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<sup>1</sup> The merchant generators alleged that in the absence of the results of an RFP administered by an independent fourth party the Commission was not competent to determine whether a utility's proposed new resource is appropriate, because the Commission would not have enough information to make a reasoned decision. This could only be the case if three different entities all failed in the following regards: (1) the utility failed to properly present its case; (2) the ORS failed to properly investigate the case; and (3) interested parties (which one would assume would include merchant generators) failed to intervene and present whatever additional information they assume the Commission is lacking. The merchants presented no evidence that such failures have or will occur.

Corporation) the Commission decided to open a generic docket to explore a formal RFP process for utilities that are considering alternatives for adding generating capacity. Calpine filed a petition for reconsideration of Commission Order No. 2005-2 with regard to the Commission's decision to open a generic docket to explore a formal RFP process rather than moving directly to a rulemaking proceeding to promulgate a rule requiring competitive bidding for South Carolina electric utilities. By Order No. 2005-149 issued in Docket No. 2004-178-E, the Commission denied Calpine's petition, basically finding that it was premature for the Commission to embark upon a rulemaking, and explaining that its intention was to open a generic docket in order to gather the information necessary to make an informed decision as to whether it should proceed to a rulemaking regarding RFPs and competitive bidding.

On July 12, 2005, the Commission issued a Notice of Generic Proceeding and a Notice of Hearing establishing Docket No. 2005-191-E to examine the issue of competitive bidding for the procurement of additional capacity by South Carolina electric utilities and to explore whether to implement a formal RFP process for utilities that are considering alternatives for adding generating capacity. The Commission scheduled a hearing for this matter for October 26, 2005. At the hearing PEC, Duke Power Company, SCE&G, Calpine and LS Power presented testimony and evidence. The Commission initially scheduled briefs to be filed on December 5, 2005; however, at the request of the parties, by Order No. 2005-687, the Commission extended the time for the filing of briefs until December 19, 2005.

## **ISSUE**

Whether it is in the public interest to require the electric utilities of South Carolina to utilize requests for proposals (competitive bidding) administered by an independent fourth party prior to procuring any additional generation capacity resources?

## **DISCUSSION**

The overwhelming evidence presented in this proceeding demonstrates that it is not in the public interest to require utilities to utilize requests for proposals administered by independent fourth parties prior to procuring additional capacity resources.

The genesis of this proceeding cannot be over-emphasized. This proceeding was the result of a merchant generator, Calpine, intervening in SCE&G's last rate case and asserting that all electric utilities in South Carolina should be required to issue RFPs administered by independent fourth parties prior to being allowed to acquire new generating resources. Calpine is a company that is extremely financially distressed, with a stock price of less than 50 cents. It has a market capitalization of approximately \$125 million and \$17 billion of debt. It is attempting to use the Public Service Commission of South Carolina as a mechanism to create a forced market for the purchase of its electricity.

In order to justify its position that the Commission should require utilities to issue RFPs in every instance, Calpine had to find some flaw with the current resource planning process. Apparently, it could not identify any specific resources that were imprudently acquired by any South Carolina utilities (since it made no such allegations) therefore all it could do to support its assertions was to allege that the current resource acquisition

process in South Carolina is flawed and that requiring electric utilities to use a competitive bidding process administered by an independent fourth party and allowing Calpine to participate in the development of the RFP is the solution.<sup>2</sup>

The alleged flaws identified by Calpine are: (1) the electric utilities of South Carolina cannot be trusted to make prudent resource selections; and (2) the Commission, which is the independent third party charged by the General Assembly to review utility resource selections, is unwilling, incapable, or not competent to review utilities' resource selections and determine whether they are prudent. Regarding the first assertion, since neither Calpine nor LS Power could identify a single resource that has been imprudently selected by any South Carolina electric utility, the best they could do was insinuate that electric utilities in general are biased towards self-build options. Yet, this assertion was undermined by two unassailable facts: 1) PEC is currently purchasing over 800 megawatts from Calpine as a result of an RFP voluntarily employed by PEC, and Duke Power has purchased electricity from every merchant generator in the southeast; and 2) the evidence demonstrated the comprehensive resource acquisition process followed by the utilities carefully considers all purchase power options.

The unrebutted evidence conclusively demonstrated that that once a utility determines that a new generation resource is needed, it considers all potential alternatives, including purchased power, available to meet that resource need. The utilities explained that the process begins with a preliminary economic comparison of all

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<sup>2</sup> Contrary to the assertions of Calpine and LS Power, these merchant generators are not altruistically and selflessly attempting to assist the retail customers of South Carolina. They are attempting to assist their shareholders, which is entirely appropriate, however, they should have the integrity to say that rather than to masquerade cloaked in the flag of protecting the retail customer.



available resources to develop a short list of viable alternatives that will be analyzed in a more detailed economic evaluation. This preliminary economic evaluation compares like alternatives on a levelized or busbar cost basis. This technique compares the cost of capital, fuel and non-fuel operation and maintenance expense (“O&M”) of the alternatives over a range of capacity factors, without consideration of how the alternative might operate as part of the system and impact total fuel and O&M costs. Using this approach, a manageable list of alternatives is identified for final analysis.

All of the viable resource alternatives are compared by creating alternative resource plans, consisting of combinations of the alternatives that meet system reliability targets, and comparing these competing resource plans on a total system revenue requirements basis, which includes the capital cost of unit additions, incremental O&M expense of any additions, and the total system fuel costs, which includes the fuel cost of the new additions. The comparison is done on a cumulative present value of revenue requirements basis which allows a comparison of the total cost to customers over the planning horizon of twenty years or more. The comparison is based on the costs to customers and it is concern for the customer that is the driver of the resource plan results.

Once the most cost-effective plan is identified, it is tested to determine how it performs under variations in the key assumptions, such as changes in fuel price forecasts, or potential changes in environmental regulation, such as the implementation of a carbon tax or more restrictive air emission caps. These sensitivity analyses provide additional insight as to how robust a resource plan is as conditions change, knowing that they most certainly will change from the base assumptions used in the planning process. They also

provide some bases for qualitative considerations, such as fuel diversity and technological risk.

This process produces a preferred new resource and resource plan. At this point **all** purchase power opportunities are then considered to determine whether a power purchase is more cost effective than a self-build option.

Thus, there is no self-build bias. The utilities' resource selection process expressly considers all purchased power opportunities. In addition, as mentioned earlier, the resource mix of the utilities provides further proof that there is no self-build basis, as all of the utilities currently buy a substantial amount of power, with PEC purchasing over 7% of its capacity needs from Calpine alone. Finally, as mentioned earlier, there has been no allegation that any resource selected by a utility was imprudent.

Turning to the merchant generators' allegation that the Commission is incapable or not competent to determine whether a utility's decisions are indeed reasonable with regard to resource selection, this begs a number of questions that demonstrate the assertion is frivolous. First, if the Commission is incompetent or incapable in the area of utility resource selection, then logic would indicate that the Commission is incapable or incompetent in all other areas. Thus, all utility actions and decisions must be the subject of some type of collaborative committee process overseen by an independent fourth party. Obviously, this is not the case.

Secondly, the South Carolina General Assembly has established both the agencies and the process to provide the very oversight advocated by the merchant generators. By statute, all electric utilities must annually file with the Commission 15-year forecasts of the electricity needs of their customers and the resources the utilities project will be

required to meet the needs of their customers. These resource plans are public documents available for review by all interested parties. Prior to a utility building a new generating facility, it must apply to the Commission for a certificate of public convenience and necessity, prove through an evidentiary public hearing open to all interested parties that the proposed new resource is needed and appropriate, and obtain an order from the Commission allowing its construction. Finally, before a utility is allowed to recover the cost of a new generating resource, it must endure a second open-evidentiary proceeding in which all interested parties are allowed to review and challenge the costs incurred by the utility to construct the resource. The South Carolina General Assembly has established the Office of Regulatory Staff and specifically charged them with investigating, evaluating and reviewing utility actions and proposals and presenting the results of such evaluations and reviews to the Commission. Thus, the current process is more than adequate to ensure utilities make prudent resource selections.

Most importantly, the issue in this proceeding is NOT whether RFPs are valuable tools that should be used by electric utilities. In fact, PEC recently issued an RFP for new capacity to serve its Western Region. Every party to this case agrees that in the majority of cases some form of RFP should be used to select new capacity resources. The issue, as stated earlier, is whether it is in the public interest to deprive the utilities who are responsible for ensuring cost-effective and reliable service, of the flexibility and discretion to determine when to utilize this tool. When properly framed, the answer to this question practically shouts out to the reader. The entity that is ultimately responsible for the provision of electricity to the citizens of South Carolina must have that discretion or there will be harm to the system, the utility and its customers.

PEC witness Waters explained that while an RFP is a useful tool in soliciting potential power supplies and ultimately demonstrating that a final decision is the most cost-effective alternative, requiring utilities to issue an RFP in every instance where they have a need for a new resource is unnecessary, and in some instances, possibly harmful. From his own personal experience, he gave several examples that demonstrate how requiring an RFP might jeopardize reliability and the pursuit of lowest cost resources for the customer.

His first example involved a situation where a utility is faced with quickly serving a major new customer. This customer's load is substantial and requires the utility to add resources or face violating its reliability criterion. Given that an RFP process takes from 9 to 12 months to complete, allowing time to create and distribute the RFP, allow for vendor responses and fully analyze the submittals, there would not be enough time to go through the process and meet the lead time requirements for adding the new units. In this situation requiring the utility to issue an RFP would not be in the utility's customers' best interest.

Another example offered by Mr. Waters is where a utility becomes aware of a unique opportunity that provides an obvious benefit to customers, and for which there is likely to be a significant competitive market to obtain the capacity offered. There are several ways this might occur, but one example is when another utility has built a new generating unit, and its load has not grown sufficiently to fully utilize the resource, or possibly this new resource was not allowed in rate base by another state's regulatory body. Such a utility has an incentive to sell the capacity for some term, and a South

Carolina utility may be able to acquire such excess capacity at an attractive price if it can act quickly.

Witness Dr. Julius Wright eloquently explained that the adoption of a mandatory RFP procedure would dramatically change, in a negative way, the regulatory compact between the Commission and the utilities it is charged with regulating. That compact being: the utilities are responsible for managing the business of producing, transmitting and delivering electricity and the Commission is charged with determining the reasonableness and prudence of the utilities' actions. If a mandatory RFP process is adopted, the Commission's role changes from one of oversight and approval to one of resource planning management and resource decision-making. Furthermore, if the Commission allows some independent fourth party to be involved in the drafting of the RFP and the selection of the winning bidder, the Commission has in essence given up a portion of its regulatory authority and oversight.

Dr. Wright also emphasized that one of the key risks associated with depriving a utility of the discretion to choose the sources upon which it relies to meet the needs of its customers is the impact on the utility's ability to consider the financial integrity and ability of the winning bidder to meet its contractual obligations. A perfect example of Dr. Wright's concern is one of the parties to this proceeding, i.e. Calpine. As mentioned earlier, Calpine is in extreme financial distress. If it files for bankruptcy, it is then statutorily allowed to reject, that is "walk away from" any existing contracts. In fact, PEC at this time is very concerned over the impact of a Calpine bankruptcy on PEC's purchased power agreement with Calpine for the Broad River 850 MW facility for which PEC has a long-term purchased power contract. To deprive a utility of the judgment calls

associated with making power purchases forces the utility to assume a risk over which it has no control. Clearly this is inappropriate.

SCE&G Witness Lorick also articulated numerous other variables involved in selecting a new capacity resource that requires experienced business judgment. These include variables such as: the size of the generation resource to be acquired; the fuel type and generation technology needed; the location of the new facility on the utility's transmission grid and its ability to support the location's specific needs of the utility such as voltage support; the facility's response time to changing load; its operating and maintenance costs; its location with regard to fuel transportation infrastructure; the environmental impact both present and anticipated of the resource; its ability to be retrofitted to meet new requirements and regulations; its fuel efficiency; and the vendor support for the equipment involved. All of these factors must be weighed and considered. The duty to do such weighing and considering rest with the utility. The duty to determine whether the utility's decisions in this regard are reasonable under the circumstances rests with the Commission.

Finally, regarding the merchant generators' allegation that RFPs are necessary for a utility or the Commission to determine the cost of available resources, it must be remembered that PEC and the other utilities providing electric service in South Carolina have been in the electric utility business for several decades. They have fulfilled their obligation to plan for and to serve South Carolinians well with reliable power at affordable rates. They are constantly studying, tracking and evaluating the costs of new generation and the market price for purchased power. They know what it costs to build a combustion turbine (CT) or a combined cycle facility (CC). They know what power is

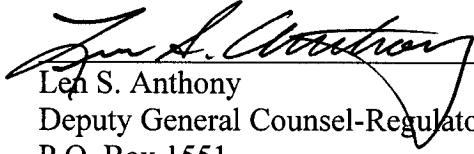
selling for in the forward markets. When seeking to build new CTs and CCs they request bids from the equipment manufacturers. When seeking to build new baseload generation they request proposals from the contractors capable of constructing such plants. They do not always need to issue an RFP to know who may be in a position to provide the resource we need or the price of the resource we need. Thus, in many situations, issuing an RFP is simply a waste of the utilities' customers' money.

### **CONCLUSION**

The record in this proceeding is totally devoid of any evidence that any electric utility has ever selected an inappropriate resource to meet the needs of its customers. Similarly, the record in this proceeding is completely devoid of any evidence that this Commission is not competent or capable of reviewing utility decisions pursuant to the statutes promulgated by the South Carolina General Assembly to ensure that the utility decisions are reasonable. The utilities using the tools and the flexibility available to them have a long history of providing an adequate and reliable source of electricity to South Carolinians at low rates. The laws of South Carolina ensure that all utility decisions with regard to resource additions are subject to review and approval through a public evidentiary proceeding in which all interested parties are allowed to participate. Restricting the discretion of the electric utilities to bear the ultimate responsibility for ensuring the reliability of electric service provided to their customers by requiring them to engage in RFPs developed by the very bidders who participate in the RFP and administered by independent fourth parties will impair the utility's ability to fulfill this responsibility and undermine the regulatory authority of the Commission.

Respectfully submitted this 16th day of December, 2005.

PROGRESS ENERGY CAROLINAS, INC.



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